Moody's Investors Service

Global Credit Research
Credit Opinion
23 APR 2008

Credit Opinion: Transport for London

Transport for London

United Kingdom

Ratings

Category	Moody's Rating
Outlook	Stable
Senior Unsecured -Dom Curr	Aa1

Contacts

Analyst	Phone
Thomas Amenta/London	44.20.7772.5454
Georgios Petsis/London	
Yves Lemay/New York	1.212.553.1653

Key Indicators

Transport for London

	2002/03	2003/04	2004/05	2005/06	2006/07
Transport Grant / Total Revenues (%)	48.5	52.8	45.3	41.8	40.1
Own Source Revenues / Total Revenues (%)	51.3	51.5	53.6	57.0	58.5
Surplus / Deficit for the year / Total Revenues (%)	0.5	2.1	0.5	-0.1	-0.9
Current Assets / Current Liabilities (%)	164.3	113.0	116.2	117.3	133.1
Long-Term Borrowings / Net Assets (%)	--	--	1.5	5.2	8.5
General Fund & Earmarked Reserves / LT Borrowings (x)	--	--	5.7	1.8	1.1
General Fund & Earmarked Reserves/Interest Payable (x)	--	--	-273.93	-132.00	-39.02

Opinion

Credit Strengths

Credit strengths of Transport for London:

The strategic importance of TfL to national transport plans, as the major provider of transport within the capital; its importance has been reinforced by the recent ten-year funding settlement to 2018 from government, which will cover the 2012 Olympic Games, the completion of major upgrades of the London Underground, and the Crossrail project.

The relatively high level of oversight and control exercised by the UK government. TfL's legal status as a local authority requires it to follow the Chartered Institute of Public Finance and Accountancy (CIPFA) code in establishing that its borrowing is prudent and affordable. TfL is legally obligated to set a balanced budget on an annual basis, and it has kept to the borrowing limits it has agreed with the government.

TfL's near monopoly on public transport provision in London, via its ownership of London Underground Ltd, its control of the Greater London bus network, and its growing participation in above-ground rail services.

TfL's record of meeting goals and keeping to the financial projections laid out in its published business plan. Some of its more several notable successes have been: the Congestion Charge, improvements to the quantity and quality of bus services, extensions of the Docklands Light Railway (DLR), the addition of a seventh carriage to all Jubilee Line trains, and the establishment of the London Overground rail services.

The stable and experienced management team of TfL, which can draw on expertise in the fields of transport administration, public policy, risk management and corporate finance.

Credit Challenges

Credit challenges of Transport for London are:

A projection of GBP8.1 billion of borrowing on its balance sheet by 2018; this includes GBP4.3 billion of direct borrowing in addition to GBP3.3 billion previously agreed, as well as the potential for up to GBP500 million of existing and fully budgeted PFI contracts coming on balance sheet. The financing of the Tubelines PPP and other PFI contracts provide further debt-like burden as finance leases.

Uncertainty regarding longer-term financial impacts of the refurbishment of the London Underground and the delivery of Crossrail. The provision of GBP33 billion of grant to 2018, TfL's control of the farebox and its capacity to manage - and if need be reduce - other transport investments should mitigate these impacts in the medium term.

Whilst fares and congestion charges are fully under the control of the Mayor of London, the need to provide affordable services limits the additional amounts that may be raised from these sources over the long term.

Recurring costs are expected to grow in line with the continuing expansion of the transport network and will place either direct or indirect demands on funds available to TfL.

Rating Rationale

The Aa1 debt rating of Transport for London (TfL), with stable outlook, reflects the application of Moody's rating methodology for government-related issuers. In accordance with this methodology, the rating reflects a combination of the following inputs: (1) a Baseline Credit Assessment of 10 (on a scale of 1 to 21, where 1 represents the lowest credit risk); (2) the Aaa rating of the UK government; (3) a high probability of support from the national government; and (4) high default dependence.

The BCA of 10 can be attributed to TfL's exposures to expensive and complex projects and to the national and local influence of politics, which may influence fare levels, subsidies, and project selection. It also takes into account the burden of existing debt, PFI and PPP agreements, as well as the consensus, stability and effectiveness of its funding and management plans to date.

The anticipated transfer of the Metronet contracts to TfL and the decision to go forward with Crossrail make TfL directly responsible for a significantly larger share of capital construction costs. Keeping the out-turns of the Underground and Crossrail projects within the newly agreed GBP39 billion funding envelope to 2018 may be a significant challenge. TfL's success in managing these projects could potentially influence the level and stability of future funding settlements.

TfL continues to have a significant level of contingent liabilities related to the financing of the Tube Lines PPP and other PFI contracts. The Metronet administration showed that these contracts could be managed in the case of failure by the contractor without significant negative impact on TfL's finances or its ability to deliver key investment programmes. It also proved, however, that such adjustments can take years and offer little near-term flexibility.

The high support assessment for TfL reflects the importance of the transport system and infrastructure improvement in London by the UK government as reflected in the ten-year funding settlement and the agreement to proceed with Crossrail. High support also reflects the continuing high profile of transport for the Olympics in 2012 and the comfort letter for the Tubelines PPP.

High default dependence reflects TfL's necessary reliance upon UK government funding and its lack of economic viability as a standalone entity.

Rating Outlook

The rating outlook is stable.

What Could Change the Rating - Up

Closer alignment of TfL to the UK government could provide upward pressure on the rating; nevertheless, it is unlikely that TfL will achieve the same rating on its debt as the UK government without the support of provisions which approach an effective guarantee on its obligations.

What Could Change the Rating - Down

TfL's rating could be the lowered were it to take on a substantially higher, unsupported financial burden in its financial projections, were the UK government to signal a clear dilution of its support for TfL, or were it to persistently under-perform in meeting operational or financial goals.

Recent Developments

On 6 February 2008, the Department for Transport confirmed a GBP39 billion funding programme for Transport for London as part of the Government Comprehensive Spending Review of 2007 ("the 2007 settlement"). The settlement includes TfL's portion of the funding for GBP16 billion Crossrail project, the refurbishment and upgrade of the London Underground tube system, preparations for the 2012 Olympic games, further expansion of bus and rail systems and other programmes. This agreement subsumes and extends by ten years an earlier 2004, five-year settlement.

The settlement includes GBP33 billion of grant to 2017/18 and a further GBP4.3 billion of debt and provision for roughly GBP500 million of impacts of financing leases on TfL's balance sheet, above the GBP3.3 billion of debt previously agreed to be incurred by 2010. Total borrowing for the years of 2008/09 and 2009/10 has been increased to GBP1.25 and GBP1.10 billion. The full budgetary impact of this agreement on TfL is to be presented in a revised business plan, which is not expected to be available until autumn 2008.

The 2007 settlement covers funding to meet TfL's contribution to the Crossrail project of GBP7.7 billion. TfL would raise GBP2.7 billion (counted within the GBP8.1 billion noted above), backed by new fare revenue. The government has agreed that the Mayor of London will also be empowered to raise an additional GBP3.5 billion of debt via the Greater London Authority for the benefit of the project. This GLA debt would be supported by a supplementary business rate, assessed on local businesses with a rateable value over GBP50,000. This debt would be counted within TfL's contribution to Crossrail, but would not be a liability of TfL. New legislation would be required to enact this programme and the first amounts are not expected to be raised until 2010/11. The balance of the funding for the Crossrail project is planned to come from additional grant to the project of GBP5.2 billion, from GBP2.3 billion of financing from Network Rail for project works taking place on the national above-ground rail network, and from other developer contributions and project efficiencies.

Crossrail is to be managed by TfL as a wholly owned subsidiary, Cross London Rail Links (CLRL). TfL and the Government will share inflation risk for the project, and the Department for Transport and TfL as sponsors of the project have agreed thresholds to trigger changes in the control and cost allocation of the project, were it to come under difficulties in financing or project management. Moody's anticipates that the risks of management and costs of Crossrail to TfL will become clearer as the main procurements are defined.

The 2007 settlement also includes amounts to unwind the Metronet PPP debt structure and support the transfer of contracts to TfL for the interim period, as described below.

On 18 July 2007, Metronet Rail BCV Limited and Metronet Rail SSL Limited were placed into a special form of insolvency, PPP Administration. On 5 February 2008, the put options granted to the senior funders of the Metronet Rail BCV Finance plc and Metronet Rail SSL Finance plc were exercised; and the conditions to exercise were met. The put options were settled for GBP1.74 billion in a total payment by TfL to the two finance companies. TfL is working to transfer the two Metronet contracts to two nominee companies of Transport for London. This step will integrate the larger part of London Underground improvements under the direct management of London Underground. Whilst a full review of the former Metronet investment plans is continuing, on 1 April 2008 TfL reached an agreement with key current contractors to continue the upgrade works on the Victoria Line and other parts of the sub-surface network. TfL states that the new permanent structure for the BCV and SSL concessions may take up to early 2010.

Despite the potential for significant cost pressure from the more direct exposure to major construction and refurbishment projects - as well as the longer-term uncertainty of government funding beyond 2018 - Moody's expects that financial management and co-operation between the Government, the Mayor, and TfL will preserve stable finances for TfL. Any significant changes to the transport plans and funding for London are expected result from a deliberate and orderly process.

Moody's views central government support for the company as high. The resolution of the Metronet Put Option, the agreement for the funding of Crossrail, the length of the funding settlement and its specific discussion of borrowing plans of TfL are all evidence of the continuing congruence of TfL's plans and overall transport funding strategy by the Government.

ABOUT MOODY'S SUB-SOVEREIGN RATINGS

National and Global Scale Ratings

Moody's assigns national scale ratings in certain local capital markets in which investors have found the global rating scale provides inadequate differentiation among credits or is inconsistent with a rating scale already in common use in the country. Moody's National Scale Ratings are opinions of the relative creditworthiness of issuers and issues within a particular country. While loss expectation will be an important differentiating factor in the ultimate rating assignment, it should be noted that loss expectation associated with National Scale Ratings can be expected to be significantly higher than apparently similar rating levels on Moody's global scale. Moody's National Scale Ratings rank issuers and issues in order of relative creditworthiness: higher ratings are associated with lower expected credit loss.

National Scale Ratings can be understood as a relative ranking of creditworthiness (including relevant external support) within a particular country. National Scale Ratings are not designed to be compared among countries; rather, they address relative credit risk within a given country. Use of National Scale Ratings by investors is only appropriate within that portion of a portfolio that is exposed to a given country's local market, taking into consideration the various risks implied by that country's foreign and local currency ratings.Country Ceilings for Foreign Currency Obligations.

Moody's assigns a ceiling for foreign-currency bonds and notes to every country (or separate monetary area) in which there are rated obligors. The ceiling generally indicates the highest rating that can be assigned to a foreign-currency denominated security issued by an entity subject to the monetary sovereignty of that country or area. In most cases, the ceiling will be equivalent to the rating that is (or would be) assigned to foreign-currency denominated bonds of the government. Ratings that pierce the country ceiling may be permitted, however, for foreign-currency denominated securities benefiting from special characteristics that are judged to give them a lower risk of default than is indicated by the ceiling. Such characteristics may be intrinsic to the issuer and/or related to Moody's view regarding the government's likely policy actions during a foreign currency crisis.

Baseline Credit Assessment

Moody's baseline credit assessment incorporates the Government Related Issuer's (GRI) intrinsic credit strength and accounts for all aspects of the entity's existing (or anticipated) activities, including benefits (such as regular subsidies or credit extension) and/or detriments associated with the government relationship. In effect, the baseline credit assessment reflects the likelihood that a GRI would require extraordinary support.

Extraordinary Support

Extraordinary support is defined as action taken by a supporting government to prevent a default by a Government Related Issuer (GRI) and could take different forms, ranging from a formal guarantee to direct cash infusions to facilitating negotiations with lenders to enhance access to needed financing. Extraordinary support is described as either low (0% - 30%), medium (31% - 70%) or high (71% - 100%).

Default Dependence

Default dependence reflects the likelihood that the credit profiles of two obligors may be imperfectly correlated. Such imperfect correlation, if present, has important diversifying effects which can change the joint-default outcome. Intuitively, if two obligors' default risks are imperfectly correlated, the risk that they would simultaneously default is smaller than the risk of either defaulting on its own.

In the application of joint-default analysis to GRIs, default dependence reflects the tendency of the GRI and the supporting government to be jointly susceptible to adverse circumstances leading to defaults. Since the capacity of the government to provide extraordinary support and prevent a default by a GRI is conditional on the solvency of both entities, the more highly dependent -- or correlated -- the two obligors' credit profiles, the lower the benefits achieved from joint support. In most cases, the close economic links and/or close intergovernmental fiscal arrangements between a GRI and its associated government result in a medium to high degree of default dependence.

Default dependence is described as either low (0% - 30%), medium (31% - 70%) or high (71% - 100%)